Office - Supreme Court, U.S.
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SEP 23 1982
ALEXANDER L. STEVAS,
CLERK

No. 81-523

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

CONTAINER CORPORATION OF AMERICA,
Appellant,

v.

FRANCHISE TAX BOARD,
Appellee.

**On Appeal From The United States Court Of Appeals
For The State Of California
For The First Appellate District**

BRIEF AS AMICUS CURIAE IN SUPPORT OF BRIEF OF APPELLEE FRANCHISE TAX BOARD

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STATEMENT OF INTEREST

The FARMERS EDUCATIONAL AND COOPERATIVE UNION OF AMERICA, known and identified by long usage and custom as the NATIONAL FARMERS UNION, is an association of family-scale farmers and ranchers in the principal agricultural regions of the Nation.

National Farmers Union is a non-profit agricultural educational organization, founded in 1902 and incorporated in the State of Texas, with its national headquarters located since 1941 in Denver, Colorado.

National Farmers Union's membership consists of 350,000 farm and ranch families, with significant membership in about 20 states which have an immediate demonstrable interest in the case at hand.

Because the decision reached by this Court will not only determine the right of the State of California to continue to use the unitary apportionment system for establishing the amount of income subject to taxation, but will also similarly affect the taxing powers of more than twenty other states, who now use adaptations of that system, or other states which might choose in the future to adopt the unitary apportionment system, National Farmers Union views the matter as being of great significance to farmers of the affected areas.

This brief is filed with the written consent of both parties pursuant to Rule 28 of this Court.

SUMMARY OF ARGUMENT

The tax climate of the U.S. is already tilted in favor of foreign investors in the U.S., and in favor of the flight of capital of the nation's corporations into foreign investment, both trends being motivated by the prospect of tax avoidance.

To acquiesce in enlargement of the above discriminatory policy would create incentives for subterfuges designed for concealment of taxable income. The opportunity to attribute U.S. corporate profits on paper to foreign subsidiaries should not be encouraged by this Court.

The Commerce Clause of the U.S. Constitution does not override the reserved taxing power of the state governments.

Discrimination between domestic and foreign transactions cannot be distinguished from discrimination be-

tween types of interstate transactions. Both are governed by the same clause of the Constitution.

Invalidation of the California tax would result in discriminatory treatment based solely on geographic considerations.

Fairness to state and local taxpayers requires that those engaged in interstate and foreign commerce pay a fair share of the burdens of government.

The Court should affirm the judgment of the California Courts, sustaining the California tax in this case.

ARGUMENT

A ruling favorable to Container Corporation of America (CCA) in this case would have undesirable ramifications for state governments and legislatures, for domestic enterprises and ultimately for our society.

Farmers and rural residents and their communities would be adversely affected by such a decision.

It would be detrimental to the general welfare for this Court to create a clear and unjustifiable discrimination in favor of foreign commerce as against domestic interstate and intrastate commerce.

The tax climate of the United States federal government is already tilted in favor of foreign investors, allowing them to shield their earnings from taxation, and in favor of the flight of capital of U.S. corporations into foreign investment.

A decision in favor of Container Corporation of America would further exacerbate the situation.

The Commerce Clause Of The Constitution Does Not Over-Ride The Reserved Taxing Power Of The State Governments.

Article I, Section 8, Clause 3, the frequently-noted "Commerce Clause," grants to Congress the power "To regulate commerce with foreign nations, and among the several states, and with Indian tribes."

Amendment 10 to the Constitution decrees that "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."

The Courts have held that "The Commerce Clause does not, however, eclipse the reserved 'power of the States to tax for the support of their own governments' *Gibbons* v. *Ogden* 9 Wheat 1, 6 L Ed 23 (1824). . . . rather the clause is a limit on state power." *Boston Stock Exchange* v. *State Tax Commission* 429 U.S. 318, 50 L Ed2d 514, 97 S Ct 599 (1977).

"It is not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden." *Western Live Stock* v. *Bureau of Revenue*, 303 U.S. 250 82 L Ed2d 823, 58 S Ct 546 (1938). "Taxes are sustained when they do not discriminate against interstate commerce." *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274, 51 L Ed2d 326, 97 S Ct 1076 (1977).

The fact that foreign commerce may be involved is irrelevant for purposes of state income tax. This Court has sustained state taxes which included so-called "foreign source" income in the apportionment base and foreign activities in the apportionment formula. *Bass, Ratcliff & Gretton* v. *State Tax Commission*, 266 U.S. 271, 69 L Ed 287, 45 S. Ct 82 (1924), *Mobil Oil Corp.* v. *Commissioner*, 445 U.S. 425, 63 L Ed2d 510, 100 S Ct 1223 (1980).

It Would Be Contrary To The Public Interest To Acquiesce In Discriminatory Policy, Thereby Creating The Further Incentive For Subterfuges Designed For The Concealment Of Taxable Income.

A decision of this Court to bar the use of the unitary apportionment system would have the effect of acquiescing in discrimination in favor of multinational corporations to the detriment of domestic corporations. It would interfere with the rights of the states to tax income which is earned, in part, in their respective states and also lead, undoubtedly, to a restructuring of business acitivity in order to avoid state taxes.

Such a decision would encourage multinational corporations to engage in a tax "shell game," doing what multistate corporations often did before the Uniform Act, namely, to assign their profits to jurisdictions which allow them to avoid or minimize tax liability. The opportunity to attribute U.S. corporate profits on paper to foreign subsidiaries or associates should not be encouraged by this Court.

Such a decision would enlarge tax loopholes for multinational corporations, increasing the burden on domestic corporations, and aggravating the fiscal predicaments of state governments.

The apportionment of unitary business income for state tax purposes has been recognized by the courts in numerous decisions, notably in *Bass, Ratcliff & Gretton, supra*, as cited in *Mobil Oil Corp. supra*, in which the Court declared that "The State was justified in attributing to New York a just proportion of the profits earned by this Company from such unitary business."

The states cannot exist without the independent exercise of their taxing authority. Neither are state's need

budgetted annually by the federal government, nor are state revenues raised by the federal government. Each jurisdiction must exercise its taxing authority to raise funds for its own needs and to carry out its own policies. This should be particularly obvious in a time when important financial responsibilities are to be transferred from the federal to the state level.

This Court, therefore, should not make a decision which would hamper the efforts of the states to tax equitably, uniformly and fairly, the income, which is attributable to activities within those states and to raise their own necessary revenues.

Discrimination Against Interstate Commerce Is Not Limited To Favoritism For Intrastate Commerce, But Also May Arise As A Result Of Distinctions Between Classes Of Commerce.

In *Boston Stock Exchange*, *supra*, the Court had occasion to analyze a state tax which refined the area of discrimination to encourage one type of interstate commerce as compared to an alternative. The Court held:

> "There has been no prior occasion expressly to address the question whether a State may tax in a manner which discriminates between two types of interstate transactions in order to favor local commercial interests over out-of-state businesses, but the clear import of our Commerce Clause cases is that such discrimination is constitutionally impermissible."

It follows that the same reasoning should apply to foreign commerce vis-a-vis interstate commerce. Discrimination between interstate and foreign transaction cannot be distinguished from discrimination between types of interstate transactions. Both interstate and foreign commerce are governed by the same clause of the Constitution.

"The prohibition against discriminatory treatment of interstate commerce follows inexorably from the basic purpose of the Clause. Permitting the individual States to enact laws that favor local enterprises at the expense of out-of-state businesses 'would invite a multiplication of preferential trade areas destructive' of the free trade which the Clause protects. *Dean Milk Co.* v. *Madison*, 340 U.S. 349, 356, 95 L Ed 329, 71 S Ct 295 (1951)." *Boston Stock Exchange, supra.*

Therefore, construing a state tax to discriminate in favor of foreign commerce with respect to interstate commerce should be equally impermissible.

Disallowing the use of the unitary apportionment system would have two unfortunate effects. First, it would tend to subsidize foreign investment in U.S. property, notably in U.S. agricultural land, by sheltering the profits of foreign investors from effective state taxation. Second, it would spur the flight of U.S. capital into foreign investments chiefly for tax avoidance.

These prospects cannot be taken lightly by National Farmers Union. An invasion of foreign capital into American agriculture would, in our view, be disruptive, indesirable and un-needed. Further, we contend, recent foreign acquisitions of U.S. farm land have been on an alarming scale.

More American farm land has come under foreign ownership and control in the past five years than in the preceding fifty years.

Fifty four percent of all farm land parcels owned or controlled by alien investors have been acquired since 1975. By value of farmland owned or controlled by aliens, the proportion acquired since 1975 is 75%.

Most recent data, reported under Public Law 95-460, the Agricultural Foreign Investment Disclosure Act of 1978, shows that the trend to foreign acquisitions accelerated in 1981. At the end of 1981, the farm acreage held by foreign investors was 62% larger than a year earlier. Foreign interests were involved in about one-fourth of the agricultural land transfers.

We are not contending that all investment by U.S. companies in foreign plants and subsidiaries or all investment by foreign companies in American plants and subsidiaries is undesirable. But, we do question such investment where its principal motivation is tax avoidance.

United States tax policy, in our view, must recognize the economic self-interest of the United States.

In the past two decades, U.S. policies have allowed tax-motivated decisions diverting investment capital into activities abroad at the expense of modernizing domestic plants. Thus, we now have aging plants and less competitive situations in steel, autos, electronics and other enterprises.

The Bureau of Economic Analysis of the Department of Commerce projects that capital expenditures by majority-owned foreign affiliates of U.S. companies will total $50 billion in 1982, an increase of 11% over a year earlier, following upon a 7% increase in 1981 and a 30% increase in 1980.

The same Bureau of Economic Analysis reported in April, 1982, that the total assets of U.S. multinational corporations have grown by an average of 11% a year in the past 12 years, with the growth rate higher for the foreign affiliates than for the U.S. parents. Total assets of these multinational firms now are nearing $2 trillion.

The California Tax Involved In This Case Does Not Discriminate Against Intrastate, Interstate Or Foreign Commerce.

The California tax involved in this case is an apportioned tax. The apportionment base includes all the income of the unitary business, and the apportionment formula includes all the apportionment factors of the unitary business. California applies the tax on a worldwide basis. It includes the income and activities of the foreign subsidiaries or divisions of United States-based businesses, and it includes the income and activities, wherever located, of foreign-based businesses. See *Hearings Before the Committee on Foreign Relations, United States Senate*, "Tax Treaties with the United Kingdom, the Republic of Korea, and the Republic of the Phillipines." No distinction is made on the basis of the location of the activities or the business.

CCA argues that the tax discriminates against businesses engaged in foreign commerce because foreign countries do not tax on an approtioned basis. The answer to this argument was provided by this Court in footnote 12 in *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267, 57 L Ed2d 197, 98 S Ct 2340 (1978), where it stated:

> "The simple answer, however, is that whatever disparity may have existed is not attributable to the Iowa statute. It treats both local and foreign concerns with an even hand; the alleged disparity can only be the consequence of the combined effect of the Iowa and Illinois statutes, and Iowa is not responsible for the latter.
>
> "Thus, appellant's 'discrimination' claim is simply a way of describing the potential consequences of the use of different formulas by the two States. These consequences, however, could be avoided by the adoption of any uniform rule; the 'discrimination' does not inhere in either State's formula."

Invalidation Of The California Tax Because Of Foreign Commerce Considerations Would Create A Distinction Between Foreign Commerce And Interstate Commerce Which Would Result In Discriminatory Treatment Based Solely Upon Geographical Considerations.

If this Court should strike down the California tax here involved on the grounds that it is an interference with foreign commerce, it would be requiring the States to accord different tax treatment to similarly situated businesses solely on the basis of the location of the business. This proposition was rejected by this Court in *Michelin Tire Corp.* v. *Wages*, 423 U.S. 276, 46 L Ed2d 495, 96 S Ct 535 (1976), with respect to ad valorem property taxes assessed against imported goods no longer in import transit.

> "By definition, such a tax does not fall on imports as such because of their place of origin. It cannot be used to create special protective tariffs or particular preferences for certain domestic goods, and it cannot be applied selectively to encourage or discourage any importation in a manner inconsistent with federal regulation."

The same reasoning is applicable to State income taxes. The tax here involved is not selectively applied; it is uniformly applied. The commercial domicile or location of business activities is irrelevant for purposes of the application of the tax. For "[i]t seems clear, strictly as a logical proposition, that foreign source income is no different from any other income when it comes to determining, by formulary apportionment, the appropriate share of the income of a unitary business taxable by a particular state. This does not involve state taxation of foreign source income any more than does apportionment—in the case of a multistate business—involve the taxation of income arising in other states. In both situations the total

income of the unitary business simply provides the starting point for computing the in-state income taxable by the particular state." Rudolph, *State Taxation of Interstate Business: The Unitary Business Concept and Affiliated Corporate Groups*, 25 Tax L. Rev. 171, 205 (1970).

As a point of conjecture, consideration should be given to the effect of a decision invalidating the California tax on a foreign-based business which would have its tax reduced on the basis of the unitary business principle. Could a State successfully deny the use of the unitary method to such a corporation? It would seem not. A foreign corporation would appear to have a compelling argument to be allowed to opt for the unitary method under the nondiscrimination clauses of Friendship, Commerce and Navigation Treaties and conventions for the Avoidance of Double Taxation. If a State applies the unitary method to businesses engaged in interstate commerce, how can it discriminate against corporations in foreign commerce which request it. As the Court indicated "*encourage* or discourage." Does it matter that the selection is made by the taxpayer rather than by the State?

Fairness To Local Taxpayers Requires That Those Engaged In Interstate And Foreign Commerce Pay Their Fair Share Of The Burdens Of Government.

The Court said in *Michelin*, *supra*:

> "There is no reason why local taxpayers should subsidize the services used by the importer; ultimate consumers should pay for such services as police and fire protection accorded the goods just as much as they should pay transportation costs associated with those goods."

The same rationale applies with respect to income taxes.

In *Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. 450, 3 L Ed 2d 421, 79 S Ct 357 (1959), the Court stated:

> "It is axiomatic that the founders did not intend to immunize such commerce from carrying its fair share of the costs of state government in return for the benefits it derives from within the State."

The Court should continue to honor this axiom and sustain the tax in this case. To do otherwise will require the States to either curtail services or increase levies upon solely intrastate taxpayers. Neither course is in the best interest of the States or their citizens.

National Farmers Union views this with gravity because the decision of this Court could directly affect the level of taxes payable by farm families if the lawful taxes now paid by foreign persons and corporations were to be substantially reduced.

Taxes paid by farm operator families are already at highly burdensome levels. In 1982, it is our projection that American farmers will pay about $16 billion in real estate, personal property and state and federal income taxes. The tax load may even exceed the total net income of U.S. farmers, now estimated to fall in the range of $14.5 to $18.5 billion.

If, due to either Court action or legislation, the unitary method of computing taxable income were to be disallowed, this would shift a substantial annual tax load, estimated at between $700 and $900 million from the foreign persons and corporations to state and local taxpayers. Since state sales and income levies are already at what many regard as scarcely-tolerable levels, the tendency would be for the revenue lost by the states to be sought largely from the property tax base. In many

states, agricultural land is an important part of that tax base.

In contrast, the tax burden imposed on the multinational corporations by the U.S. federal government and the several states is relatively light.

Because of concessional tax treaties and through the use of tax shelters, multinational corporations and foreign subsidiaries of U.S. corporations are able to minimize their tax liability under the U.S. federal income tax.

As an example, the letter of Secretary of the Treasury, W. Michael Blumenthal on May 4, 1979, to the Congress, transmitting a report, entitled "TAXATION OF FOREIGN INVESTMENT IN U.S. REAL ESTATE," is instructive.

In this letter, Secretary Blumenthal observes that:

> "Under present law, capital gains realized by nonresident aliens and foreign corporations are not subject to U.S. tax unless they are 'effectively-connected' with a U.S. trade or business. The Treasury Report finds that foreign persons rarely incur capital gains tax on the disposition of their U.S. property holdings."

The Treasury Report acknowledges that the "U.S. exemption for gain on real property not effectively connected with a U.S. trade or business is unusual by international standards."

Further, the Treasury Report calculates that in 1979, the revenue lost by failure to tax capital gains on property sold by foreign investors amounted to about $276 million.

CONCLUSION

Nondiscriminatory treatment of interstate and foreign commerce requires that this Court sustain the right of the States to apply the unitary tax principle to all taxpayers over which nexus exists regardless of where their activities are conducted or where they are based. Fairness to wholly intrastate taxpayers requires that taxpayers engaged in interstate and foreign commerce pay their fair share of the cost of the governments from which they derive benefits.

Both goals can be served by sustaining the California tax in this case. The Court should affirm the judgment of the California Courts.

Respectfully submitted,

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